

INFORMATION BULLETIN #9

SALES TAX

JANUARY, 2003

DISCLAIMER: Information bulletins are intended to provide nontechnical assistance to the general public. Every attempt is made to provide information that is consistent with the appropriate statutes, rules and court decisions. Any information, which is not consistent with the law, regulations, or court decisions is not binding on either the Department or the taxpayer. Therefore, the information provided herein should serve only as a foundation for further investigation and study of the current law and procedures related to the subject matter covered herein.

SUBJECT: Agricultural Production Exemptions

REFERENCES: IC 6-2.5-4-5, IC 6-2.5-5-1, IC 6-2.5-5-2, IC 6-2.5-5-5.1, 45 IAC 2.2-5-1, 45 IAC 2.2-5-2, 45 IAC 2.2-5-3, 45 IAC 2.2-5-4, 45 IAC 2.2-5-5, 45 IAC 2.2-5-6, 45 IAC 2.2-5-7

I. Purchases

The general rule for the application of sales or use tax is that a purchase of tangible personal property to be used in Indiana is subject to tax unless a specific exemption is available.

Indiana law provides several exemptions from sales and use tax relating to agriculture production. The exemptions are limited to purchases of animals, feed, seed, plants, fertilizer, insecticides, fungicides, and other tangible personal property; and agricultural machinery, tools, and equipment to be directly used in

the direct production of food or commodities that are sold either for human consumption or for further food or commodity production.

The phrase directly used in direct production means that the property must be integral and essential to the production process. Property is integral and essential to the production of food or commodities if it is necessary to carry on production and plays a key role in the actual production of the food or commodity. Some examples of property that are directly used in direct production will be discussed later.

A. Animals, Feed, Seed and Farm Products

Purchases of animals, animal feed, seeds, fertilizer, plants, insecticides, fungicides and other similar items of tangible personal property are exempt from sales and use tax if two conditions are met. The person acquiring the property must directly use the property in the direct production of food or commodities for sale and the person must be occupationally engaged in the production of food or commodities which are sold for human or animal consumption or for further use in food or commodity production.

To be occupationally engaged in the production of food or commodities a person must be regularly engaged in the commercial production for sale of vegetables, fruits, crops, livestock, poultry and other food or agricultural products. Persons who do not intend to operate at a profit or who produce food or agricultural commodities for sale as a hobby are not occupationally engaged in the production of food or agricultural commodities.

The term feed includes salt, grains, tankage, oyster shells, mineral supplements, vitamins and other generally recognized animal feed. Fertilizer means any commodity that contains one or more substances to increase the available plant food content of the growing medium. Generally, the contents of the fertilizer must become part of the plants grown and must be used as a fertilizer.

Examples:

1. Bob Jones plants 600 acres of soybeans. He intends to sell the soybeans at a profit. He buys insecticide to spray the soybeans. The insecticide fails and his crop is eventually ruined. The purchase of the insecticide is exempt. The fact that the crop was not sold at all does not make the purchase of the insecticide taxable.
2. Same facts as in example 1, except that Bob uses the insecticide to protect his prize rhododendrons. The plants are not sold nor does Bob intend to sell them. The insecticide is taxable. In this example

the insecticide is not being directly used in the direct production of agricultural products for sale.

3. Lab Animals Corporation raises animals to be used in research. The animals are not sold to be eaten by humans. The research is to develop medicines to be used to prevent or cure human and animal diseases. Lab Animals Corporation cannot purchase animal feed exempt from tax under the agricultural exemptions.
4. Ride-A-Horse, Inc. purchases twenty horses to be used as riding animals. The horses would be taxable because the animals are not directly used in the direct production of food or agricultural commodities.

B. Agricultural Machinery, Tools and Equipment

The purchase of agricultural machinery, tools and equipment are exempt from sales and use tax if the machinery, tools and equipment are directly used in the direct production, extraction, harvesting or processing of agricultural commodities. If the machinery or equipment is not directly used in the direct production of agricultural commodities, but is designed for use in the gathering, moving or spreading of animal waste, the machinery or equipment may be exempt if the following conditions are met.

1. The person acquiring the equipment acquires it for use in conjunction with the production of food or commodities for sale.
2. The person acquiring the machinery or equipment is occupationally engaged in the production of food or commodities that are sold for human or animal consumption or are used for further food or commodity production.
3. The machinery or equipment is designed for use in gathering, moving, or spreading animal waste.

Examples:

1. Fencing used to confine livestock during breeding, gestation, farrowing, calving, nursing and finishing is exempt from tax. During these activities the fencing plays a key role in the raising of the livestock.
2. John Doe, cattle rancher, purchases needles, syringes and vaccine pumps to inoculate his herd to prevent various cattle diseases. The equipment is exempt from tax because it is essential and integral to the raising of cattle. Without vaccinations, many of John's cattle could die.
3. Sam Johnson owns 800 acres and grows wheat to be sold to a corporate bakery. Sam purchased lumber,

nails, concrete and tools to build a silo to house his grain drying operation. The lumber and other building materials are exempt from tax. The silo is exempt from tax because the grain drying operation is integral and essential to the processing of the grain. The grain can not be sold to Sam's customer until the grain is dried, thus the silo is necessary and plays a key role in the processing of the grain. The tools used to build the silo are taxable because the tools are not used in the processing of the grain.

4. Sam Johnson buys lumber, nails and concrete to build a silo to store grain after it has dried. Sam sells the grain to his customer once the grain is dried without further processing. The materials are taxable. Once the grain has dried no further processing takes place before the grain is sold, thus the processing of the grain is complete after drying. A silo used to store dried grain may be necessary but it does not play a key role in the processing of the grain because the processing of the grain is finished. If the storage silo were used half of the time to dry grain and the other half to store dried grain, then the silo would be fifty percent exempt and fifty percent taxable. If Sam also operates a mill where the grain was ground, then the dried grain storage silo would be exempt from tax. The silo would be exempt because the silo would be a temporary storage place for work-in process. The courts have determined that the temporary storage of property between processing steps is integral and essential to an integrated production process.
5. Corporation C is engaged in the business of selling agricultural chemicals and fertilizers to farmers. Corporation C purchases an applicator that will be used to spread the chemicals and fertilizer on its customer's fields. The purchase of the applicator is exempt from tax because the application of fertilizers and agricultural chemicals is necessary and play a key role in the raising of crops.
6. Corporation A runs a large hog farm operation where pigs are bred, raised, slaughtered and packaged to be sold to wholesale grocers. The pigs are kept in confinement buildings. The confinement buildings maintain the integrity of the product and control the animal's growth environment to facilitate the raising process. Any property which is directly used in the process of raising the pigs, such as heat exchangers, fans, thermostats, heat pumps, roof vents and the

confinement stalls or porches would be eligible for exemption. These materials are exempt because if a person occupationally engaged in producing food for human consumption chooses to raise livestock in confinement buildings these materials are both essential and integral to the production process.

C. Utilities

Under certain circumstances Indiana law provides an exemption from sales tax for the purchase of the following utilities: electrical energy, natural and artificial gas, water, steam and steam heat. The utilities listed above are exempt from tax if they are directly used in the direct production of agricultural commodities. Thus, if a person occupationally engaged in the production of agricultural commodities purchases electricity to dry grain, the electricity would be exempt because drying grain is integral and essential to the production of grain. The purchase of electricity to run a fan to ventilate a dried grain storage silo would be taxable because the farmer purchasing the electricity is not going to subject the dried grain to further processing.

If a person, engaged in agricultural production, buys utilities from a public utility and predominantly uses the utilities directly in the direct production of agricultural commodities, then the utility is not required to collect tax on the purchase of the utilities. Each meter measuring the consumption of a utility is treated separately for purposes of determining whether a utility is predominantly used in production. Further, a utility is predominantly used in agricultural production when more than fifty percent of the utility is being directly used in direct agricultural production.

Before utilities may be purchased tax exempt from a public utility, an application for a predominant use exclusion must be filed with the Department of Revenue, form ST-200. If approved, an exemption certificate, ST-109, will be mailed to the public utility by the department. If a person is entitled to an exemption for only a percentage of their utilities, all of the tax must be paid and a refund claimed for the exempt percentage. Utilities purchased from a source other than a public utility may be purchased exempt using an exemption certificate. See section II, Exemption Certificates.

Examples:

1. Grow, Inc. has two meters for electricity and buys natural gas directly from the wellhead. One of the meters measures electricity used to dry grain. Fifty five percent of the electricity

measured by the meter operates drying equipment used to dry grain. Another meter measures electricity used to heat the chicken coop and power the egg incubators. Forty-nine percent of the electricity measured by the meter is used for the incubators and fifty-one percent for general heating. The natural gas is used to heat the farmhouse and to dry grain which is harvested during periods of high humidity. Sixty percent of the natural gas dries grain.

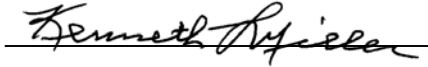
The electricity meter for the grain silos is not taxable because the electricity is predominantly used directly in the direct processing of grain. Drying grain is integral and essential to the processing of grain. The electricity for the chicken coops is not predominantly used in direct production because only forty-nine percent of the electricity is directly used in the direct production of agricultural commodities. Therefore, Grow, Inc. is only entitled to an exemption for forty-nine percent of the cost of the electricity. The natural gas, though predominantly used in direct production, is only sixty percent exempt from tax because the gas was not purchased from a public utility.

To purchase the electricity for the silos tax exempt, an ST-200 application must be filed with and approved by the Department of Revenue. The sales tax charged for the chicken coop electricity must be paid to the utility and a claim for refund filed with the Department to recover the exempt percentage. Tax should be paid for purchase of the natural gas and a claim for refund filed to recover the tax paid for the exempt percentage. The Department of Revenue realizes that the percentage of exempt use changes from year to year. Thus, the Department may request a new application to be filed, if the Department believes the percentage of exempt consumption has changed.

II. Exemption Certificates

There are two types of exemption certificates that may be used to purchase exempt agricultural-use property. Form ST-104 allows property to be purchased exempt from tax if the property fits under one of the agricultural exemptions provided by Indiana law. The ST-104 may only be used as a single purchase exemption certificate and may not be used as a blanket exemption. The purchaser must complete the form for each purchase before the exemption will be allowed. The purchaser does not need a certificate for each item purchased but rather a certificate must be completed each time a person purchases one or more exempt items.

Form ST-106 is the Department's blanket agricultural exemption. The certificate may be issued to suppliers to be kept by the suppliers to substantiate exempt sales of the items listed on the front of the certificate. As with any other exemption certificate, the ST-106 must be completely filled out and signed before it is valid.

A handwritten signature in black ink, reading "Kenneth L. Miller", written over a horizontal line.

Kenneth L. Miller
Commissioner